

People Power

Short Term Political Price vs Long Term Public Good

One of the great challenges in any society is increasing administered prices, or reducing subsidies in a politically palatable manner. All democracies wrestle with the problem of reconciling the clash between the short-term political price a government has to pay for temporarily unpopular decisions, and the long-term social good which results from such decisions. Political parties and governments are always mindful of the fact that unpopular decisions, even if they are in the long-term interest of the people, may cost them their power.

The recent increase in petrol and diesel prices on account of dramatic rise of international crude oil prices holds a mirror to this classic dilemma of democratic governments. But such a dilemma is not merely the government's problem; the interests of future generations and the whole society are linked to the capacity of a government to take the correct, even if painful decision. The media, civil society, political parties and opinion makers have the duty to examine these issues fairly and objectively and raise the standards of debate.

Given a choice, no human being would like to pay a higher price for a commodity. Therefore, resistance to price increase is understandable. But the oil pool deficit in the current year would have been about Rs. 73,000 crore if prices were not increased to partially offset this deficit. Even then the impact of price increase is only Rs.9200 crore. The Government also reduced the customs duty from 10 to 7.5% and thus exchequer loses about Rs. 6500 crore, reducing the deficit further. The Government is issuing oil bonds to a tune of Rs. 28,000 crore to reduce the oil pool deficit. To that extent, the burden on government increases, except that there is deferred cash outflow. Finally, the oil companies will share a loss of revenue of Rs. 24,000 crore, and convert into subsidies to consumers. All these and other steps would bring down the deficit to a manageable level of Rs. 3000 crore. Clearly even with price increase, the government and oil companies are bearing an additional burden of Rs. 52,000 crores, and government is foregoing a revenue of Rs. 6500 crore.

With international crude prices skyrocketing to \$ 70 per barrel and beyond, any government would have no choice but to pass on at least part of the burden to the consumers. Most countries have substantially enhanced oil prices. We import over 60% of the oil from OPEC countries. In contrast, over 80% of British oil needs are met from their own North Sea oil fields. Despite that, petrol is priced at 95 pence per litre, or nearly Rs. 82 per litre. Most of the nations have realized that global oil prices are likely to further increase as demand continues to grow and supplies stagnate. Over the next few decades we are going to face the severest oil crisis for over a century.

Importing countries have to brace themselves for two consequences of this oil crisis. First, oil prices need to be increased, as the purchasing cost cannot be absorbed by governments. Second, the world's dependence on oil needs to be reduced, and

consumers and industry should have an incentive to go for energy efficient technologies, more sustainable life styles and renewable fuels. Otherwise, if governments continue to price oil lower than purchase costs, they would be acting irresponsibly. Fiscal deficits will rise unmanageably forcing government to bankruptcy; and societies will suffer grievously as oil becomes costlier and more scarce. That is the reason why rich countries, which can afford to absorb the costs, are also raising prices in the interests of society.

One of the criticisms and concerns raised by our economists and parties is the low tax-GDP ratio in India. Our taxes probably account for 16 – 18% of GDP making it one of the lower shares among large economies. Clearly, better infrastructure, education, healthcare, justice, policing and other public goods cost more money, and low tax base will hurt the poor and inhibit economic growth. If governments give up taxes in order to keep oil prices low, it will only deplete the treasury at the cost of much-needed public goods and services. If other taxes are raised to subsidize oil, it only means that the government is removing the money from the citizen's right pocket and putting it in the left pocket!

Given our low tax-GDP ratio, and the appalling quality of infrastructure and public services, the burden of oil price increase has to be borne by consumers. What we should demand is that every rupee collected is wisely spent by the government for the larger good of our children. Greater transparency, decentralization, accountability, and citizen empowerment must be the watch words.

In fact, the subsidies in energy sector have largely been just dysfunctional and detrimental to the economy. Low price of LPG and kerosene is leading to unauthorized diversion of subsidized LPG and kerosene as automobile fuel. The government is losing an estimated Rs. 15,000 crore per annum in subsidies through diversion. Adulteration with kerosene, which is priced low, is leading to serious environmental pollution and damage to vehicles. Subsidized oil and excise duty concessions on automobiles are promoting private motors leading to more pollution, congestion, higher oil consumption and trade deficits.

Finally, if we have to give energy subsidies, what would be the best forms? There are two prime candidates for such subsidies. First, India needs high quality, reliable public transport. This will reduce oil consumption, pollution and congestion. Second, viable alternative, renewable, indigenous fuels like ethanol need to be subsidized. This will pave way to the shift to indigenous fuels and reduce green house gas emissions and global warming, rejuvenate agriculture and put our money in our own people's pockets. Even the US is subsidizing ethanol to promote its production. Brazil took sensible policy decision years ago, and is producing ethanol at about \$ 25 – 30 per barrel equivalent, saving vast amounts of foreign exchange, and providing cheaper fuel for domestic consumption.

Sometimes, being kind is to be cruel, and being tough is to be wise and compassionate. We need to have a comprehensive review of our energy and pricing policies, and delink government from oil pricing decisions. The market should determine the prices, and all the subsidies saved should be ploughed back to the community for education, healthcare, infrastructure and alternative fuels. We must focus on long term energy security, renewable biofuels and reduced dependence on costly, imported oil. Addiction to oil subsidies and emission of green house gases will hurt the nation as well as mankind. Politicians have an obligation to look at the bigger picture, speak truth, and mobilize public opinion in favour of rational policies. If today's transient comfort is at the cost of better tomorrows, our children will pay a heavy price for our thoughtless follies.

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